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BEFORE THE

SUBCOMMITTEE ON TRADE
HOUSE COMMITTEE ON WAYS AND MEANS

ON

H.R. 5081, THE FAIR TRADE IN STEEL ACT OF 1984

Mr. Chairman and Members of the Subcomittee:

I am happy to be here today to discuss H.R. 5081, the Fair Trade in Steel Act of 1984. H.R. 5081 would place a 5-year quota on imported steel restricting imports to about 15% of the apparent domestic supply of all steel mill products. In return for this protection, the steel industry is required to use substantially all cash flow from the steel sector to reinvest in and modernize this sector. We understand that the intent of this legislation is to give the steel industry a period of relief during which time it would seek to regain its competitiveness in the U.S. market.

The bill raises a number of important issues that need to be considered. First, the steel industry is undergoing considerable change: modern steelmaking capacity has been built in

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low-wage, developing countries, adding to worldwide excess capacity; demand for steel is declining as downstream industries substitute other materials; and the structure of the U.S. steel industry is changing with the rise of competitive minimills at the expense of large integrated producers. How does the forecasted impact of H.R. 5081 mesh with the current state of the steel industry? Second, does the steel industry need such protection? The United States currently has a number of formal and informal agreements with the European Common Market, Japan, Mexico, and Brazil which restrict steel exports from these countries to the United States. In addition, there are a number of existing statutes under which the steel industry has sought and obtained relief from foreign competition. Third, is the level of assistance which would be provided by H.R. 5081 the correct amount? Fourth, is a quota system the best way of responding to the needs of an industry undergoing major changes in demand and technology? Fifth, are the costs of imposing quotas balanced by the expected benefits? Such costs include: projected increased costs to consumers of steel products; reduced competitiveness of downstream U.S. industries if the cost of steel inputs increases; and the potential for retaliatory action by foreign governments against U.S. exports of products which are currently competitive on world markets.

Other witnesses have testified on the problems facing the U.S. steel industry and the likely costs and benefits that would accrue if this legislation were to pass. I would like to comment today on whether, as currently structured, H.R. 5081 is an effective and equitable vehicle for contributing to a turn around in the financial health and competitiveness of the U.S. steel industry.[1]

We view the use of trade protection for the benefit of a particular industry as equivalent in certain respects to the provision of direct financial assistance using appropriated tax revenues. A quota will likely raise prices to consumers and lower their real income in the same way a new tax would. Financial resources are transferred from the public to the targeted industry, regardless of whether this transfer comes in the form of a Treasury check or additional revenue derived from government-imposed restrictions, such as a quota. The steel quota bill should, therefore, incorporate all the safeguards that we would expect to find in a direct expenditure or government loan program providing equivalent benefits. Such provisions currently contained in the bill are not adequate. I would like to discuss in greater detail some of the provisions of the bill that need improvement as well as other provisions that should be added.

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[1]The issue of the design of another type of government assistance, large loan guarantees, is discussed in a recent GAO report (GAO/GGD-84-34). Many of the issues discussed in that study are applicable to the evaluation of any form of assistance (including quotas) focused on a single firm or industry. An earlier GAO statement for the record on October 4, 1983 for the Subcommittee on Economic Stabilization of the House Comittee on Banking, Finance and Urban Affairs addressed an institutional mechanism for developing steel policy.

CONSIDERATIONS OF EQUITY

The laws of the United States provide mechanisms for restructuring firms that are in financial difficulty. The provisions of the bankruptcy laws provide a mechanism for firms in financial difficulty to solve their problems. In a restructuring under the bankruptcy laws, constituent groups bear some of the cost of the restructuring. For example, unsecured creditors may only receive a portion of their claims or nothing at all. Union contracts may be rejected or revised along with revisions to benefits and salaries of managers. In fact, many concessions may even be made prior to a bankruptcy filing because the constituent groups believe that they have more to lose in a court-ordered reorganization or liquidation than by extending concessions in a pre-bankruptcy "workout."

The quota bill as it now stands does not have specific provisions for contributions to a turn-around of the steel industry by the constituent groups that have the most to gain--shareholders, managers, workers, and creditors. The public is expected to fund a rebirth of the steel industry while those who stand to gain most are neither asked nor expected to make specific contributions to the effort. In contrast, look at the Chrysler loan guarantee program. While the law provided the authority for a federal loan guarantee of up to $1.5 billion, it also required the commitment of an additional $2 billion by constituent groups, including creditors, shareholders, labor, and the governments of the states and localities in which Chrysler's plants were located. The actual extension of the federal loan guarantees was contingent on a number of factors including the receipt of support from other sources on a dollar-for-dollar matching basis.

Legislation that might equitably contribute to enhanced competitiveness of the U.S. steel industry should require contributions from all constituent groups that will gain from a resurgent steel industry and not just from the public.

IDENTIFYING ALL THE PROBLEMS THAT MUST BE ADDRESSED

The public policy objective of H.R. 5081 appears to be to make the U.S. steel industry more competitive--if not in world markets, at least in the domestic market. To succeed it is necessary to identify and address the underlying causes of steel industry problems. For example, to what extent are the industry's current problems attributable to such factors as (1) unfair competition from subsidized foreign producers, (2) wages that are far above the average U.S. industrial wage and the wage rates paid by foreign competitors, (3) outmoded plant and equipment, (4) poor management, or (5) changes in demand and the structure of the market? Without attention to these issues, there is little likelihood a 5-year quota will provide for meaningful long term correction.

Legislation that might contribute to a return to competitiveness by the industry should include provisions that require identification of the whole set of factors that detract from its competitiveness. Such a determination should be made precedent to the extension of any assistance to the target industry.

FINANCIAL NEEDS AND RESOURCES

One factor that should be considered when establishing a government program to provide assistance to an industry is how much financial aid is needed to get the job done and how much would be provided under different legislative proposals. As discussed above, there is no requirement for an explicit determination as to the causes of the industry's problems or what resources are required to correct these problems. Furthermore, under H.R. 5081 the amount of resources that would be made available to the steel sector for reinvestment is not readily determinable. It is contingent on cash flow from steel operations that in turn depends on the performance of the U.S. economy over a 5-year period. Therefore, the amount of additional cash flow that would be provided to the steel industry by H.R. 5081 is unknown and may be too little or too much.

Legislation that might contribute to enhanced competitiveness of the U.S. steel industry should include provisions that require a determination as to the resource needs of the industry and a way of ensuring that an appropriate level of funds will be provided.

TIMING OF DETERMINATIONS AND BENEFITS

Aid to a targeted industry in the private sector should be dependent on a demonstration that the undertaking in question is financially viable. For example, when the Congress passed the Chrysler Loan Guarantee Act, it did not unconditionally nor immediately grant Chrysler a government-backed loan guarantee. It created a set of conditions that had to be met to qualify for a loan guarantee and a board of high-level government officials to determine if the conditions were met. Among other things, Chrysler had to demonstrate, through financing and operating plans submitted to the Loan Guarantee Board, that it had investment and product plans that (1) could be financed with the resources made available through the loan guarantee program and (2) would enable the company to become financially viable without additional federal assistance. It should be noted that negotiations with Chrysler over its financing and operating plans took many months and that a half a year elapsed between the date the statute was enacted and the date the company was able to qualify for and receive the first loan guarantees.

The steel quota bill would grant the quota and its accompanying revenue without the steel industry having to demonstrate anything and would place only limited investment requirements on the industry. The question has been raised in earlier hearings before this subcommittee whether H.R. 5081 would require the industry to do anything different than it is now doing to satisfy the requirement.

A bill that might contribute to the enhanced competitiveness of the U.S. steel industry would specifically require submission by industry of investment, operating, and financing plans, that would demonstrate the planned restructuring that would enable the industry to become competitive with the level of resources made available by the quota, within the 5-year period of protection.

ASSURING THE EFFECTIVENESS OF FUNDS PROVIDED

It seems reasonable that in return for the quota protection, steel firms should provide more specific commitments to insure that funds made available under the program are used for the intended purposes. Without appropriate safeguards, it is conceivable that at the end of the 5-year period envisioned in the legislation, banks will have received repayment of their outstanding loans, shareholders and bondholders will have received their dividends and interest payments, management and labor will have continued to receive their current real wages, and the industry will be no more competitive than it is today. In other words, given the lack of safeguards, it is possible that the sacrifices made by the public under this bill will do nothing more than provide benefits to the industry's constituent groups.

A bill that might contribute to the enhanced competitiveness of the U.S. steel industry should include provisions to insure that the resources provided to the industry through government intervention are used for the intended purpose; i.e., to contribute to the competitiveness of the U.S. steel industry and not to benefit constituent groups. Such safeguards might include a requirement that in return for the benefits received the companies cease corporate acquisitions unrelated to the steel industry. Furthermore, they might be required to generate internal funds for investment in modern steelmaking capacity by spinning off some non-steelmaking subsidiaries. Creditors might be required to agree to a moratorium on the repayment of debt principal and to provide interest-rate concessions to increase the amount of revenue from steel operations that would go into investment in steelmaking facilities. State and local governments of localities in which steel companies are located might be required to make tax concessions. And lastly, management and labor might be required to make wage and benefit concessions.

Such provisions would have a fourfold benefit. First, they would contribute to the fiscal efficiency of the program by helping to ensure that all added revenue resulting from the protected steel operations was used to enhance the competitiveness of the U.S. steel industry. Second, they would help to ensure that those who stand to gain the most from a healthier steel industry share the cost of realizing that goal. Third, making the publicly provided benefits from the quota contingent on financial contributions from constituent groups would give the publicly provided funds a multiplier effect. Every dollar of the quota subsidy would be supplemented by constituent group contributions invested in realizing the public policy goal. And fourth, such contributions would contribute to the economic efficiency of such a program by providing a market test of the worth of the quota. It is easy for the industry to support a quota when it stands to receive substantial benefits without making corresponding contributions or sacrifices. A requirement that the industry's constituent groups, as well as the public, contribute to the support of the industry's financial needs places a real price on the benefits that the current supporters of the quota bill stand to receive. In so doing, it would also imbed in the program a set of behavioral incentives that would increase the likelihood that the objectives of the program would be realized.

TYPE OF ASSISTANCE

One final observation that should be made with respect to H.R. 5081 relates to the type of assistance to be provided to the steel industry. The government has available a wide range of policy instruments that can be used to achieve public policy objectives. Aid can be given to an industry in the form of quota protection as envisioned in this bill, but equivalent aid can also be provided in the form of direct subsidies, tax expenditures, loan guarantees, and exemptions from antitrust and regulatory requirements. Each policy tool differs with respect to the effectiveness and equity with which it can achieve its objectives. If the regeneration of the U.S. steel industry is a desirable public policy goal, should the type of assistance considered in this legislation be restricted to a quota? There are alternatives or combinations of alternatives that may be preferable to the quota. For example, one of the principal problems with a quota is the dilemma posed by "free riders." There is no way the benefits of the quota can be denied to those that do not meet the statutory requirement concerning investment in steelmaking operations. At what point does the Secretary of Commerce determine that the investment requirement is not being met--when

10% of the industry is not meeting the test? 20%? 51%? One of the weaknesses in the quota is that it does not permit the government to narrowly target assistance to those firms that comply with the statutory requirements. However, if quota protection were coupled with some form of direct subsidy, the full benefit of the program would consist of the quota plus other benefits. Those firms that do not comply would be able to benefit from the quota protection but would not receive the other benefits that make the package genuinely beneficial.

CONCLUSION

A quota bill that included the type of provisions discussed above would be both equitable and structured in such a way as to increase the likelihood of increased competitiveness of the U.S. steel industry. If such a bill were under consideration, the debate could focus on the costs, benefits, and national interest in using government intervention in such an undertaking. However, as it now stands, the bill does not include such provisions. We question how equitable and effective the bill can be without them.

Mr. Chairman, this concludes my prepared statement and I will be happy to try to answer any questions you may have.